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ILLICIT FINANCIAL FLOWS ARE THE ACHILLES HEEL OF CAPITALISM

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"Save for a brief slowdown during the financial crisis, illicit financial flows have been allowed to go unchecked over the past decade. In 2012, illicit outflows reached a staggering new peak of $991bn." The report just published by the *Global Financial Integrity* in Washington argues that, if this is put into perspective, it means that for every single one of the $89.7bn in development aid that entered these developing countries in 2012, over $10 in illicit financial flows came out. If the problem of illicit financial flows is allowed to go unchecked, development aid will continue to fight and uphill, and in many instances, a losing battle.

The report also compares illicit outflows to foreign direct investment in the said developing countries and finds that, despite it being much larger than aid flows at $5.7 trillion over the ten year period, it was still way beneath the level of illegal outflows. Foreign Direct Investment and Official Development Aid combined come in at slightly less that illicit outflows, at $6.5tr. An estimated 77.8% of illicit financial flows – 77.8%, are due to trade misinvoicing.

This analysis is based on published statistics which the authors believe falls short of measuring all unrecorded financial flows as several major components are not included, not least services and intangibles, a favourite area for trade misinvoicing which account for about one fifth of world trade. Nor does the data reveal cash movements primarily from criminal activities, such as drug trading, human trafficking, much counterfeiting, etc. In other words the report's estimates are very conservative.

The five top exporters of illicit capital over the past ten years on average are China, Russia, Mexico, India and Malaysia but the Middle East North Africa Region (MENA) witnessed the largest percentage increase in outflows at 23.4% per annum. Sub-Saharan Africa followed at 13.2%. Developing Europe's large share in the flow is attributable primarily to the Russian Federation which briefly surpassed China in 2011 to become the world's top exporter before ceding this place back to China in 2012. No doubt with the ongoing crisis it will regain it in 2014.

The only time these illicit financial flows slowed down was, briefly, during the financial crisis. But, overall, as the President of *Global Financial Integrity*, which publishes this report, Raymond Barber had noted, in a book published a decade ago[1], these figures are catastrophic for economic development in Africa, the Middle East, many Asian countries and the Russian Federation. It suggests that campaigns to increase Western aid to African countries are widely off the mark. The rot lies much deeper in the system and is growing as officials are basically turning a blind eye. The report also helps to explain why the World Bank, despite 60 years of hard work by some of the best brains in the business and hundreds of billions of dollars spent, has found success in eradicating poverty elusive, in some countries indeed quite impossible.

One of the more interesting ratios which helps to assess the problem is the ratio of illicit outflows to gross domestic product. Sub-Saharan Africa comes lowest in terms of the gross volume of capital it is losing but it has the highest illicit outflow to GDP ratio of any region from 2003 to 2012. These outflows amounted to 5.5% of the region's GDP, Developing Europe followed at 4.4% and Asian and the MANA region stood at 3.7%.

Country rankings by largest average illicit financial flows between 2002 and 2013 rank Egypt at 23rd place with an average outflow of $3.7bn, Algeria at 46th with an outflow of $1.57bn, Morocco at 9th with an outflow of $998m and Tunisia at 138th with an outflow of $28m. The figures do however pose some conundrums. How come there are 0 illicit financial flows from Tunisia from 2008 to 2012? Why are cumulative outflows from Morocco so high at $9.97bn? Cumulative outflows from Algeria over the same period are $15.75bn but the country's foreign income was a multiple of Morocco's? The figures for Russia with a cumulative figure of $97.38bn will hardly come as a surprise nor will Mexico's with a figure of $51.42bn.

Trade misinformation outflows make for interesting points. The cumulative figure for Morocco is $6.90bn, for Algeria $2.57bn and for Tunisia 0. Illicit hot money outflow is, unsurprising, high in Algeria at $13.17bn and much lower in Morocco at $3.07bn. Looking at the trade misinvoicing, one notices that overinvoicing of exports in Algeria accounted for $44.64bn over the period which suggests something is deeply flawed in the all important oil and gas export sector. In Morocco the underinvocing of imports is very large, at $8.35bn. The devil here is in the detail but the report shed light on some very puzzling statistics indeed.

Raymond Barker noted in his book a decade ago that the failure to confront the consequences of illicit financial flows and the broader question of dirty money stemmed from a "lack of will, not of solutions." He argued that US firms, and for that matter European and Japanese ones, were complicit in accepting a philosophy of "don't ask, don't tell" because for decades we have reasoned on the basis of a cost-benefit analysis that the movement of other people's money, tax evading in particular, was 'on balance OK'. The author's business experience over 30 years tallied with what any serious journalist with a good grounding in international trade and banking had known all along and – sometimes – dared to write about. Scandals do surface in the US and Europe but the scale of the problem and the extent to which it undermines western foreign policy is scarcely realised even by senior officials who have little practical experience of economic affairs.

One of the difficulties has always been in arriving at believable estimates of the magnitude of illegal flows. A 1997 United Nations report estimated the

1. *Capitalism's Achilles Heel, our Love affair with Dirty Money. What it costs our World, and How we can Reform the Free market System*, Raymond W.Barker, John Wile & Sons, 2005

international drug trade alone at $400bn a year – 8% of world trade. The flow of illicit money continues to increase while the the West persist in focusing far too much on the dispersing side of the development equation – foreign aid, World Bank financing, IMF credits and so on – while ignoring illegal return cash flows of great magnitude. Such blindness or hypocrisy is woefully inadequate as political leaders of economically developed countries seek to address the twin challenges of eradicating poverty and containing terrorism.